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Central Intelligence Agency

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Eastern Europe: Boom Market for Syndicated Lending

SUMMARY

Eastern Europe's borrowing from Western banks has rebounded sharply this year. The region raised $2.8 billion in syndicated loans on increasingly favorable terms in the first 10 months of 1985--a sharp turnaround from the early 1980s when bankers slashed lending to the East. Japanese and Arab banks have played a leading role in new lending while the importance of US and West European banks has fallen. Lenders have become more inclined toward Eastern Europe because of improved hard currency trade performance in the region in 1983-84 and a lack of comparably attractive investments elsewhere. Borrowers have taken advantage of favorable loan terms to restructure debt, build reserves, and cover shortfalls in hard currency earnings this year. [redacted] 25X1

This memorandum was prepared by [redacted] East-West Regional Economics Branch, East European Division, Office of European Analysis. It was requested by George Folsom, International Economic Trade and Security Policy, Office of the Assistant Secretary of Defense for International Security Policy. Comments and questions are welcome and should be addressed to Chief, East European Division, EURA [redacted] 25X1 25X1

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Widening Circle of Borrowers

The group of East European countries returning to the syndicated market has grown quickly this year, and many of the loans have been oversubscribed.

- East Germany secured a $500 million loan in March and in June it obtained a consortium loan for $600 million.
- Hungary in June tapped Western banks for the bulk of an $800 million World Bank cofinanced loan and Japanese banks for an additional $400 million since January.
- Bulgaria borrowed $200 million in July and $120 million in October.
- Czechoslovakia borrowed $100 million from a Western bank consortium in July.
- Four commercial banks extended an $80 million bridge loan to Romania in May, and most recently, a group of Romania's leading creditor banks agreed to try to syndicate a $167 million loan.

Only Yugoslavia and Poland, which still require debt reschedulings, remain shut out of the syndicated loan market. [redacted] 25X1
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Japanese and, to a lesser extent, Arab banks have played a prominent role in the upswing in new lending. Japanese banks, which have been looking to diversify their loan portfolios, have taken the lead or jointly managed 41 percent of the loans to Eastern Europe this year, compared to 18 percent in 1979. [redacted] increased competition from Japanese banks in the lending market has pushed down interest rates on loans to Eastern Europe. US banks have managed 15 percent of this year's loans to the East, down from 20 percent in 1979. This parallels the decline in overall US exposure to Eastern Europe. Many US banks that have managed recent loans to the region have been mainly interested in earning the management fees and have tried to sell off their portions of the loans quickly to limit exposure. [redacted] 25X1

Western Bank Motives

The lack of comparably attractive lending opportunities elsewhere largely explains the willingness, and in some cases, even eagerness of Western banks to resume lending to Eastern Europe. The financial positions of East Germany, Hungary, Bulgaria, and Czechoslovakia seem relatively more secure than those of many LDCs, especially in Latin America, where bankers feel overexposed. Not only has Eastern Europe increased the

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actual amount of borrowing, but it has also captured a greater share of bank lending to countries outside the OECD. This year 13 percent of lending to non-OECD countries has been to Eastern Europe, compared to 6 percent in 1976 and 10.5 percent in 1979. [redacted] 25X1

Eastern Europe's hard currency trade surpluses in 1983-84 and some easing of East-West tensions have been the major factors encouraging bankers to look more favorably on the region. The East European borrowers have demonstrated their ability to meet obligations by substantially cutting their debt since 1980, and, except for Romania, they have avoided rescheduling. Having made deep cuts in their Eastern Europe exposure in 1981-83, banks now feel that they have elbow room to respond to loan requests from the more creditworthy countries. Some bankers--particularly in Western Europe and Japan--believe East European imports from the West will rise with the launching of new five-year economic plans for 1986-90, and they want to reestablish ties with the better credit risks. [redacted] 25X1

Western banks have been particularly receptive to loan requests from East Germany and Hungary for additional reasons. The GDR, besides running sizable trade surpluses, boasts the strongest record of economic growth in Eastern Europe since 1982. Banks also value the West German umbrella for East Berlin, which Bonn demonstrated by guaranteeing two large West German bank loans during East Germany's liquidity squeeze. Finally, banks have found East Berlin a lucrative loan market because of the regime's acceptance of relatively high interest rates--recent loans have carried higher spreads over LIBOR than those for most other Bloc countries. The East Germans apparently prefer to have their loans oversubscribed at higher interest rates rather than obtain the most favorable terms. [redacted] 25X1

In Hungary's case, bankers are counting strongly on Budapest's reform program to improve the efficiency and competitiveness of the economy. Hungary's good relationship with the IMF--which lent it nearly $1 billion in 1982-84--has added to banker confidence. Moreover, banks have been eager to participate in World Bank cofinancing loans because they believe that the Bank's involvement guarantees that the loans are exempt from rescheduling should Budapest run into repayment problems. Japanese banks have been particularly attracted by the apparent security of these deals. [redacted] 25X1

In Romania's case, however, new lending has been less than voluntary. Recent loans have stemmed largely from bankers' desire to avoid another round of reschedulings. Disappointing export performance earlier this year seriously reduced Romania's foreign exchange reserves. Romania's leading creditor banks concluded that Bucharest needed a major loan to cover large repayments due in October under its rescheduling agreements. [redacted] 25X1

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Reasons for Borrowings

The East Europeans initially used the borrowings to repair some of the damage to their financial positions caused by the credit crunch. They took advantage of the longer maturities and lower interest rates to replace more expensive short-term debt accumulated in 1982-83. Borrowers also used the funds to boost reserves and build financial cushions against another cutback in lending to the region. East Germany and Czechoslovakia returned to the market less because they had a pressing need for cash than because they wanted to refinance obligations on better terms and reestablish their credit ratings. For example, East Germany continued to raise new credits even though it had not drawn down all its previous borrowings and sought oversubscribed loans as proof of its financial strength. In contrast, the more recent borrowing initiatives by Hungary, Bulgaria, and Romania have resulted from shortfalls in hard currency earnings caused by poor trade performance this year. [redacted] 25X1

Outlook

The borrowing trend is likely to continue, at least in the short run. Even countries with no immediate plans to draw down the funds will probably continue to exploit the shortage of lower-risk LDC borrowers. In addition, some East European countries may plan more borrowings to finance an increase in Western imports as they enter the new cycle of five-year plans. Some countries may see the need to import more capital goods to redress import cutbacks in the early 1980s and meet modernization requirements resulting from Soviet pressure to improve the quality of exports to the USSR. [redacted] 25X1

Still, an extended downturn in the region's economic health or a deterioration in East-West political relations could reverse the trend. While this year's economic slump apparently has not soured banks, lenders--and even borrowers--may become reluctant to expand Eastern Europe's debt further if trade performance continues to slide. The current enthusiasm among bankers for Eastern Europe may cool when it becomes apparent that these countries have done little to produce the sustained growth in exports needed to pay for more imports. Failures by Poland, Romania, and Yugoslavia to meet obligations under rescheduling agreements might sour some bankers on the entire region, but such a spillover seems much less likely than in 1981. A more serious threat to Eastern Europe's ability to obtain new loans might result from the reemergence of severe payments problems in LDCs. [redacted] 25X1

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